



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	2/23/01	Bill No:	AB 1636
Tax:	Sales and Use	Author:	Briggs
Board Position:		Related Bills:	AB 37 (Strickland) AB 19X (Briggs) SB 835 (Battin)

BILL SUMMARY

This bill would provide a partial sales and use tax exemption for sales of diesel fuel.

ANALYSIS

Current Law

Existing law imposes a sales or use tax on the gross receipts from the sale of, or the storage, use, or other consumption of, tangible personal property, unless specifically exempted by statute. Under existing law, sales of diesel fuel are subject to sales or use tax.

Section 6385 of the Revenue and Taxation Code provides a sales tax exemption for that portion of fuel and petroleum products sold to a water common carrier that is left on board after the water common carrier reaches its first out-of-state destination. With respect to air common carriers, Section 6357.5 provides an exemption for the sale or purchase of fuel and petroleum products sold to air common carriers when the fuel and petroleum products are for immediate consumption or shipment in the conduct of the air carrier's business on an international flight.

Current law provides that the sales tax revenue from the sale of diesel fuel is allocated on a quarterly basis to the Public Transportation Account. The money transferred to the Public Transportation Account is generally used to fund public transit projects.

Proposed Law

This bill would add Section 6356.5 to the Revenue and Taxation Code to provide a state sales and use tax exemption for the sale in this state of, and the storage, use or other consumption in this state of diesel fuel.

The proposed exemption would not apply to the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, the taxes imposed by Sections 6051.2 and 6201.2 (Local Revenue Fund) and the taxes imposed pursuant to Section 35 of Article XIII of the California Constitution (Local Public Safety Fund).

The provisions of the bill would become operative on the first day of the first calendar quarter commencing more than 90 days after the bill becomes law.

Background

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

Three bills were introduced last year to provide varying exemptions for sales of gasoline and diesel fuel. Assembly Bill 1706 (Strickland, et al.) would have provided a sales and use tax exemption for sales of gasoline and diesel fuel. AB 1706 was amended in the Assembly Revenue and Taxation Committee to remove the tax exemption language from the bill. Assembly Bill 43 (Villaraigosa) would have provided a 5 percent state sales and use tax exemption for sales of gasoline and diesel fuel for the period June 1, 2000 through September 30, 2000. AB 43 was never heard in a policy committee. Senate Bill 1777 (Burton) would have provided a 5 percent state sales and use tax exemption for sales of gasoline and diesel fuel, and also would have created a Petroleum Windfall Profits Tax that would have been imposed on refineries for failing to pass on the tax exemption savings to consumers. SB 1777 was never heard in a policy committee. The Board was *neutral* on AB 1706, *neutral, point out problems* on AB 43 and voted to *support* SB 1777.

COMMENTS

- 1. Sponsor and Purpose.** According to Assembly Member Briggs office, who is also the sponsor of the bill, the purpose of this bill is to reduce the price of diesel fuel, to help alleviate price spikes, and also to help reduce the cost of producing power by diesel powered generators.
- 2. Partial tax exemptions are difficult to administer.** Due to the method used to report partial tax exemptions, any return containing a claimed partial tax exemption must be processed manually for the proper allocation of local taxes. Current law provides for two partial tax exemptions. The current partial tax exemptions apply to sales of manufacturing equipment and teleproduction equipment. The number of returns affected by the current partial tax exemptions are relatively minor. However, this bill would cause a significant increase in the number of returns filed containing a partial tax exemption.
- 3. Transportation funding would be reduced.** Current law provides that the sales tax revenue on sales of diesel fuel be transferred to the Public Transportation Account. The revenue transferred to this fund is used to pay for various mass transit projects in the state. Creating an exemption for sales of diesel fuel would eliminate a portion of the revenues that would normally be appropriated to the Public Transportation Account.
- 4. Definition of diesel fuel.** The proposed exemption applies to sales of diesel fuel, but no definition of diesel fuel is provided. It is recommended that the proposed exemption include definition of diesel fuel as contained in Section 60022 of the Revenue and Taxation Code.

Section 60022 of the Revenue and Taxation Code provides that "diesel fuel" means any liquid that is commonly or commercially known or sold as a fuel that is suitable for use in a diesel-powered highway vehicle. A liquid meets this requirement if, without further processing or blending, the liquid has practical and commercial fitness for use in the engine of a diesel-powered highway vehicle. However, a liquid does not possess this practical and commercial fitness solely by reason of its possible or rare use as a fuel in the engine of a diesel-powered highway vehicle.

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"Diesel fuel" does not include kerosene. "Diesel fuel" includes any combustible liquid, by whatever name the liquid may be known or sold, when the liquid is used in an internal combustion engine for the generation of power to operate a motor vehicle licensed to operate on the highway, except fuel that is subject to the tax imposed in Part 2 (commencing with Section 7301) or Part 3 (commencing with Section 8601).

5. **Interstate users of diesel would continue to pay an amount equivalent to the sales tax.** Pursuant to Sections 60115 and 60116 of the Diesel Fuel Tax Law, interstate users must pay an excise tax on each gallon of diesel fuel used in this state at a tax rate of 18 cents per gallon plus an amount equivalent to the rate of sales tax imposed on diesel fuel purchased in this state. Interstate users can subsequently claim a credit for the total amount of the tax on each gallon used outside California provided they actually paid the tax to an in-state retailer. These provisions in the law were added by AB 1269 (Ch. 618, 1997) in order to eliminate the incentive for an interstate user to tank up outside California. Without conforming amendments to Sections 60115 and 60116, interstate users would still be required to pay the equivalent sales tax component on their use of diesel fuel in this state, provided this bill were enacted.
6. **Related Legislation.** Similar bills have been introduced this session that would provide an exemption for sales of gasoline and/or diesel fuel. Assembly Bill 19X (Briggs) would provide a partial tax exemption for sales of diesel fuel to be used in farming activities for a six month period. Assembly Bill 37 (Strickland) would provide a permanent sales and use tax exemption for sales of gasoline and diesel fuel. Senate Bill 835 (Battin) would exclude any federal and state excise taxes included in the selling price of gasoline and diesel fuel from the sales and use tax. The Board was neutral on AB19X and AB 37 and has not yet been presented with SB 835 for a position.

COST ESTIMATE

Some additional administrative workload would be realized as a result of notifying affected retailers and responding to inquiries. Due to the partial tax exemption, additional resources would be needed to process returns in order to ensure the proper allocation and payment of local and district taxes. A detailed cost estimate of the workload impact is pending.

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REVENUE ESTIMATE

According to the California Energy Commission, the average retail price of diesel fuel as of March 1, 2001 was \$1.630 per gallon. This price includes the state excise tax on diesel fuel, which is not subject to sales and use tax, and the sales tax. The average price minus both these taxes is \$1.344 per gallon $((\$1.630 - \$0.18) \text{ per gallon} / 1.0792 = \$1.344.)$

Consumption of diesel fuel in California is estimated to be 2.4 billion gallons annually.

Total annual sales of diesel fuel are estimated to be \$3.2 billion. $(2.4 \text{ billion gallons} \times \$1.344 \text{ per gallon} = \$3.2 \text{ billion}.)$

Revenue Summary

The revenue loss from exempting diesel fuel from the 5% state sales and use tax is estimated to be \$160 million annually. $(\$3.2 \text{ billion} \times 5\% = \$160 \text{ million}.)$

* While the state tax rate is 4.75 percent for calendar year 2001, it is assumed the tax rate will return to 5.0 percent in 2002.

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